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IN THE

Supreme Court of the United States

OCTOBER TERM, 1970

NO. 366

STATE BANK & TRUST COMPANY,

Petitioner,

v.

MARYLAND CASUALTY COMPANY,

Respondent.

PETITIONER'S REPLY TO RESPONDENT'S BRIEF OPPOSING PETITION FOR WRIT OF CERTIORARI

JAMES P. HART
904 Brown Building
Austin, Texas, 78701

TOM G. OLIVER, JR.
First Federal Savings & Loan Association Building
San Marcos, Texas. 78666

ERNEST MORGAN
P. O. Box 1288
San Marcos, Texas. 78666

Counsel for Petitioner

FIDELITY PRINTING COMPANY, INC., HOUSTON

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To The Supreme Court of the United States:

The petitioner, State Bank & Trust Company, respectfully submits this reply to the brief of Respondent, Maryland Casualty Company, opposing the petition for certiorari.

1. The Court of Appeals' "no theft" holding.

In opposing the petition for certiorari, the respondent first asserts that we have misconstrued the opinion of the Court of Appeals when we say that the Court "has held that Behring did not commit a theft." (Respondent's Brief, 2-3)

We submit that we have not misconstrued the Court of Appeals' holding. The words of the opinion speak for themselves. Moreover, when these words are considered in the context in which they are used, their evident meaning is not changed but confirmed. Having stated that "the objective

indicia" all point to the making of a loan by the Bank, the Court then rejects the Bank's contention that the transaction was a theft because of "the borrower's subjective intent" to use the loan procedure to obtain the Bank's money and not to repay it. The "no theft" reasoning of the Court of Appeals was necessary to its conclusion that *Community Federal Savings & Loan Association* v. *General Casualty Company*, 274 F. 2d 620 (8th Cir. 1960), was controlling. State Bank had pointed out in its brief that the insured in *Community Federal* claimed coverage under a clause insuring against losses resulting from "fraud or dishonesty" and that the loan exclusion in the bond in that case specifically listed a loss from non-payment of a loan which was procured through "fraud or dishonesty." Obviously in *Community Federal* the loan exclusion applied, because the identical words were used in the loan exclusion clause which appeared in the coverage clause under which the insured claimed. There could be no contention that the loan was not the kind of loan embraced in the exclusion clause. We pointed out that this case, on the other hand, should be distinguished from *Community Federal* because here coverage B, under which the Bank claims, expressly applied to a loss through "theft" but the exclusion clause did *not* exclude a loan procured through "theft." The loan in this case was *not* a kind of loan embraced in the exclusion clause. The answer of the Court of Appeals to our argument was that there was not a theft in our case. The language of the Court is as follows: (Petition for Certiorari, Appendix A, 24)

> "We are unpersuaded by State Bank's argument that *Community Federal* can be distinguished because fraud was there involved, while here there was a theft. As we pointed out earlier, we are not bound by the conclusionary characterization of 'theft' based upon the borrower's subjective intent that the District Court ascribed to the transaction."

Again, in response to our argument that, because the loan exclusion clause did not specify a loan obtained through "theft," the loss from this loan was not excluded, the Court said (Petition for Certiorari, Appendix A, 26)

> "It appears plain to us that a person subjectively intending to use an objectively bona fide loan transaction as a means of getting money from a bank with no intention of repayment does not procure a loan through theft."

In other words, the Court of Appeals held that since objectively there was a loan transaction, the borrower's criminal intent did not make the transaction a theft. In so holding, the Court simply ignored the Texas law to the contrary.

Maryland apparently tries to distinguish between procuring a loan through theft and "theft by false pretext with respect to the loan proceeds." (Respondent's Brief, 3) This obviously is a distinction without a real difference. Moreover, the attempt to make this distinction is found only in Maryland's argument and not in the opinion of the Court of Appeals. The Court of Appeals simply holds that the transaction was not a theft. Notwithstanding the Texas law on the subject, as determined by the construction of the Texas statute by the highest Texas court having criminal jurisdiction, the Court of Appeals felt free to look only to the "objective indicia," indicating a loan, and to disregard Behring's criminal intent which made the transaction a theft by false pretext under the Texas law.

2. The importance of the "no theft" holding.

Maryland argues that no "special and important" reason, under Rule 19, exists for the granting of a writ of certiorari in this case, even if the Court of Appeals held that Behring

did not commit a theft and such holding conflicts with Texas law. (Respondent's Brief, 4-5) We submit that this argument is clearly wrong.

Rule 19(b) lists, as one of the reasons the Supreme Court will consider for granting review on certiorari, that a court of appeals has decided an important state question in a way in conflict with applicable state law. The question decided by the Court of Appeals in this case is important because it relates to the construction of a standard form of bond, adopted after consultations between committees representing the insurance industry and the banking industry, and used nationwide by insurance companies in contracting with banks for protection against losses through criminal acts.

The determination of the question whether the transaction which caused the Bank's loss is a crime, such as theft, and therefore within the coverage of Clause B, is and should be a question determined by the state law of crimes. Contrary to this settled rule of law, the Court of Appeals in this case has felt free to make its own decision as to whether the transaction in which the Bank suffered its loss was a theft.

This is not a case of "isolated significance," as was the case cited by Maryland (Respondent's Brief, 4), *Rice* v. *Sioux City Memorial Park Cemetery*, 349 U.S. 70, 76 (1955). There, it appeared that because of a change in the Iowa law the issue there involved would not arise in any other case. That is definitely not the situation in this case, because it is reasonably certain that insured banks will continue to suffer losses through transactions that are crimes under state law and will assert coverage under the standard form of banker's blanket bond. The issue here involved is neither academic nor episodic. On the contrary, it is highly practical and certain to be constantly recurring.

3. The matter of the construction of the exclusion clause.

Maryland (Respondent's Brief, 5-7), like the Court of Appeals in its opinion, refuses to recognize the rule clearly stated in Texas cases (Petition for Certiorari, 12-13) that if an insurance company inserts a clause in its bond or policy which attempts to limit or exclude coverage granted in another part of the policy, the exclusion or limitation clause will be strictly construed against the insurance company and in favor of the insured. The question is not merely the construction of hazy or indefinite words (what is ordinarily thought of as an "ambiguity"), but in essence it is how much of what the insurance company has promised in one place it should be held to have taken back in another place in the same policy or bond. Under Texas cases, the insurance company must give plain notice in the policy of what it is taking back. In this case, the company in Clause B made broad promises of coverage against losses resulting from crimes, such as theft, and the question here is whether that coverage is nullified by the loan exclusion clause, which does not mention a loan procured through theft. In effect, the Court of Appeals inserted in the exclusion clause something that is not there, that is, an exclusion of a loss from non-payment of a loan procured through theft. The Court of Appeals ignored, and its decision is in conflict with, Texas cases stating rules of construction of an exclusion clause in an insurance policy.*

This question also is not one of "isolated significance." On the contrary, it involves the question whether banks, in the standard form of banker's blanket bond, get broad coverage of losses resulting from crimes or, on the other

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* Contrary to the natural conclusion that would be drawn from the quotation from the *Price* case in Respondent's Brief, 7, *General American Indemnity Co.* v. *Pepper*, 161 Tex. 263, 339 S.W. 2d 660 (1960), did not involve the construction of an exclusion clause but of a clause granting coverage in specific terms.

hand, whether that coverage is largely destroyed by the exclusion clause if the transaction on its face has the "indicia" of a loan. This question of course has great importance to banks throughout the nation, as well as to insurance companies. If the insurance company invokes federal jurisdiction because of diversity of citizenship, will the federal courts be free to make their own rules of construction, disregarding the rules of construction of exclusion clauses followed by the courts of the state where the bank is located? We submit that very clearly the state law should control and that it is important that the federal court should not enforce rules of construction in conflict with the state law on the question.

4. The conflict between circuits regarding the construction of "counterfeited."

Maryland does not deny the conflict between the decision of the Court of Appeals for the Fifth Circuit in this case and decisions in the Third and Ninth Circuits, regarding the construction of the word "counterfeited" in banker's blanket bonds. Rule 19(b) specifies as a reason which will be considered for granting review on certiorari that a court of appeals has rendered a decision in conflict with the decision of another court of appeals on the same matter. The fact that this clause has been the subject of so much litigation and even that the Supreme Court has denied certiorari in three cases where this question has been involved only serves to emphasize the fact that the question is not of "isolated significance" but is important and is repeatedly arising. Is the meaning of the banker's blanket bond coverage against losses through loans in reliance on "counterfeited" securities to depend on the plaintiff's choice of the circuit where the case is brought? The undeniable conflict between the circuits, we respectfully submit, has persisted

longer than it should. Moreover, courts of appeals should not be left free to adopt their own rules of rigid construction favoring insurance companies, contrary to the state law which requires liberal construction in favor of the insured.

CONCLUSION

We respectfully submit that the petition for writ of certiorari should be granted.

James P. Hart

James P. Hart
904 Brown Building
Austin, Texas, 78701

Tom G. Oliver, Jr.
First Federal Savings & Loan Association Building
San Marcos, Texas. 78666

Ernest Morgan
P. O. Box 1288
San Marcos, Texas. 78666

Counsel for Petitioner